TABLE OF CONTENTS

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Illinois Commerce Commission	:	
On Its Own Motion	:	
-vs-	:	00-0714
Illinois Power Company	:	
	:	
Reconciliation of revenues collected under gas adjustment charges with actual costs prudently incurred.	:	

REPLY BRIEF ON EXCEPTIONS OF THE STAFF OF THE ILLINOIS COMMERCE COMMISSION

NOW COMES the Staff of the Illinois Commerce Commission ("Staff"), by and through its attorneys, and hereby submits its Reply Brief on Exceptions to the October 17, 2001, Proposed Order ("Proposed Order" or "PO") in the above-captioned proceeding. Briefs on Exceptions ("BOE") were filed on October 31, 2001, by Illinois Power Company ("IP" or "the Company") and Staff.

Staff hereby replies to the arguments set forth in IP's BOE.

I. FREEBURG PROPANE FACILITY

IP contests the Proposed Order's conclusion that IP was imprudent for retiring its Freeburg Propane facility for the following reasons:

1.) Present Value of Revenue Requirement ("PVRR") analyses are not necessary;

2.) PVRR analysis used was improper; and

3.) PO understates the Safety, Reliability and other concerns.

Staff disagrees with the Company's position on each of the above areas. Staff believes the Proposed Order uses the appropriate prudence standard and properly recognizes the incentive that IP has to overstate its concerns in order to avoid an imprudence finding from the Illinois Commerce Commission ("Commission").

A. PVRR Analyses are Not Necessary

1. Public Utilities Act Requirements

IP argues that the PO is incorrect in concluding that IP should have performed a PVRR analysis prior reaching the decision to retire the Freeburg Propane Facility. (IP BOE at 2.) IP contends that it is not its position that "an economic analysis should never be part of an examination of the prudence of utility decisions in a PGA reconciliation", but that a PVRR analysis was not necessary in deciding to retire the Freeburg facility. (Id. at 3, footnote 1.) However, IP has failed to explain throughout this proceeding why at the time the decision was made to retire the Freeburg facility, no economic study of any type was performed. Further, if IP agrees an economic study is valuable in determining prudence, Staff fails to see how IP can continue to object to a PVRR analysis. A PVRR analysis is the only economic study that provides value to the Commission when comparing PGA gas costs to rate based facilities.

IP's disregard for the PO ignores that it has the obligation to demonstrate the prudence of its decisions. A simple "trust our decision" approach in explaining its actions to the Commission does not meet the requirements contained within Section 9-220(a) of the Public Utilities Act ("PUA") that states: "...the burden of proof shall be upon the utility to establish the prudence of its cost of fuel, power, gas, or coal transportation purchases and costs." (See 220 ILCS § 5/9-220(a).) As correctly noted in the

PO, the standard used by the Commission to assess the prudence of a utility's gas purchases under Section 9-220 of the PUA is as follows:

> "Prudence is that standard of care which a reasonable person would be expected to exercise under the same circumstances encountered by utility management at the time decisions had to be made."

Illinois Power Co. v. Illinois Commerce Commission, 245 Ill. App. 3d 367, 371 (3d Dist. 1993) (quoting the Commission); Docket No. 88-0142 at 25 (Order entered February 5, 1992). Furthermore, "[i]n determining whether a judgment was prudently made, only those facts available at the time judgment was exercised can be considered. Hindsight review is impermissible." (Id. at 371 (quoting the Commission); Docket No. 88-0142 at 25-26.)

IP wants the Commission to find it is reasonable, and acceptable, for a utility to not perform any economic analysis prior to reaching a decision to retire one of its facilities. As an illustration of this delusion IP wants the Commission to believe no studies were necessary when two facilities, the Freeburg Propane Plant and Gillespie Storage Field, are retired in the same year.

In particular, IP claims that the Commission's "standard of care" does not require a PVRR analysis to determine prudence. (IP BOE at 6) IP's definition for "standard of care," a concept not found within the PUA, would allow utilities to make decisions that are not least cost, but could not be questioned by Staff. Further, the PUA, states, in relevant part, the following:

> "Findings and Intent. The General Assembly finds that the health, welfare and prosperity of all Illinois citizens require the provision of adequate, efficient, reliable, environmentally safe and least-cost public utility services at prices which accurately reflect the long-term cost of such services and which are equitable to all citizens. It is therefore declared to be the policy of the State that public utilities shall continue to be

> regulated effectively and comprehensively. It is further declared that the goals and objectives of such regulation shall be to ensure
>
> (a) Efficiency: the provision of reliable energy services at the least possible cost to the citizens of the State; in such manner that:
>
> (i) physical, human and financial resources are allocated efficiently;
>
> (ii) all supply and demand options are considered and evaluated using comparable terms and methods in order to determine how utilities shall meet their customers' demands for public utility services at the least cost."

(emphasis added) (220 ILCS 5/1-102).

A PVRR analysis allows the comparison of various supply options in order to support a least cost decision. Further, Section 8-401 of the PUA also makes statements regarding utility service as follows:

> "Every public utility subject to this Act shall provide service and facilities which are in all respects adequate, efficient, reliable and environmentally safe and which, consistent with these obligations, constitute the least-cost means of meeting the utility's service obligations."

(220 ILCS 5/8-401).

Conducting a PVRR or similar economic analysis meets all the requirements contained within the PUA. A PVRR ensures that the utility is comparing various options and selecting the means that provides the least cost utility service rather than just blatantly making choices that are in its shareholders best interests.

2. Prior Orders

IP claims that the Commission has previously allowed the inclusion of capital projects into rate base without a demonstration of economic benefits. (IP BOE at 4.) However, IP is being selective in its discussion and previous Commission Orders clearly

indicate the IP is oversimplifying its conclusion and ignoring other statements contained within those Orders.

IP's reference to the Commission's Order in Docket No. 91-0147 (electric rate case) involved IP attempting to place into base rates a new corporate planning, budgeting, accounting and financial management system called the Business and Financial Management System ("BFMS"). (See Docket No. 91-0147, Commission's Order at 43.) However, the Order clearly indicates that IP performed a net present value analysis for the BFMS. Staff took issue, however, with the method used to conduct the analysis and questioned whether adequate savings were demonstrated to allow the project into rate base. (Id. at 43-44.)

Unlike IP's present practice, the Order in Docket No. 91-0147 demonstrates that IP historically performed economic analyses for projects, such as the BFMS, in order to support inclusion into rate base. This practice is also observed within the Commission's Order for IP's last natural gas proceeding, Docket No. 91-0183. This natural gas Order involved Staff questioning the purchase of two functional enhancements to IP's new customer information system ("CIS").

In the present case, IP attempts to use the Order in Docket No. 91-0183 to support its claim that the Order demonstrated that although IP had not performed a net economic benefits study on the CIS, the Commission found it prudent anyway. However, the Order in Docket No. 91-0183, on page 23, clearly shows IP calculated savings associated with each of the CIS functional enhancements being questioned and then also claimed further benefits from the enhancements to improved customer service.

Both of the Commission's past Orders, discussed *supra*, demonstrate that IP has historically developed economic studies, including present value analyses. While IP's specific quotes from these past two Commission Orders exhibit that the Commission did not agree with Staff on those specific adjustments, the Commission's decision was not made in a vacuum. IP performed economic analyses to support those decisions and had identified further non-quantifiable benefits as additional support for those rate base additions. Distinguishing between the prior Commission Orders and the present case is simple: at the time IP decided to retire its Freeburg and Gillespie facilities, it had not performed any economic analysis to support its decision.

IP also claims that in other instances the Commission did not require a PVRR analysis to determine prudence. (IP BOE at 6.) In particular, IP claims that the Commission allowed into rate base in Docket No. 93-0183 nine capital projects with only one of them, the Hillsboro expansion project, requiring a PVRR analysis. However, aside from portions of the CIS project discussed above, Staff did not dispute the prudence of the remaining projects. The limited discussion that was provided for the non-contested items noted that at least one additional non-contested project discussed a PVRR analysis that IP had conducted (See Docket No. 93-0183, Commission's Order at 15), several others discuss the operations and maintenance savings associated with the projects that had to come from IP's economic studies, the remaining items (such as increased frequency to purchase IP's fleet vehicles and a radio system) discuss improved reliability or improved customer service that would result or the fact the project (Supervisory Control and Data Acquisition System) was approved within IP's electric rate case from two years prior. (Id. at 14-18.) Thus, while IP may not have conducted

specific PVRR analyses for these projects, it is clear that economic studies were in fact conducted and influenced the decisions made by the Company.

IP asserts in its BOE that that the projects in past rate cases involved even more money than at issue with the retirement of the Freeburg and Gillespie facilities. (IP BOE at 6.) IP is incorrect. The CIS enhancements that Staff disputed in Docket No. 93-0183, and whose discussion IP quoted extensively within its BOE, cost $280,000 and $410,000, respectfully. (See 93-0183 Order at 23.) The combination of these two enhancements total less than $700,000 and does not exceed the Staff recommended disallowance for Freeburg of $1,273,000 and for Gillespie of $441,678. In fact, $700,000 is less than the $955,000 amount the PO recommended for the Freeburg adjustment.

Obviously, IP is attempting to cut and paste past Commission Orders together to fashion an argument to support its failure to perform any economic studies at the time it decided to retire its facilities. However, as noted *supra*, IP historically performed economic studies to calculate savings for its projects. Further, IP performed PVRR analyses when it supported its decision to expand the Hillsboro Storage field in its last natural gas rate case. (See Docket No. 93-0183.) The Hillsboro expansion is the most relevant example of how IP should review gas plant additions and retirements since it is the only example that deals with a facility that offsets natural gas supply costs. This is the same situation that IP faced when it decided to retire the Freeburg Propane Facility and the Gillespie Storage Field. The fact remains, however, that economic studies were conducted regarding the Hillsboro expansion project.

IP's failure to conduct PVRR analyses (or for that matter, any economic study) prior to reaching decisions on the retirement of the Freeburg and Gillespie facilities are, at best, gross omissions by IP's management and, at worst, decisions driven by IP's desire to increase profits for its shareholders. Staff can only conclude that IP is not making decisions on what is best for its customers but instead on what is best for its shareholders. IP does not earn a return on its investments for improvements or upgrades at facilities such as Freeburg and Gillespie until it requests and receives a natural gas rate increase from the Commission. However, increased gas supply costs, unless deemed imprudently incurred, are automatically passed through to customers through the PGA. Unfortunately, IP's failure to conduct any analyses regarding the best decision for upgrading or retiring its existing natural gas facilities suggests that IP is not making decisions from its customers' perspective.

3. IP Witness Statement

As discussed above, IP historically performed PVRR or other economic studies to support the decisions it reached. However, the record in the current proceeding indicates that this practice has changed at IP.

The cross-examination of IP witness Frank Starbody demonstrates the extent to which IP failed to meet the basic prudence requirement. When Mr. Starbody was asked to explain under what situations he believed it would be appropriate to conduct a PVRR analysis, he responded that he did not know of any situation that would require a PVRR analysis. (Tr. at 117-118.) During re-cross, Mr. Starbody noted that someone outside of the scope of his areas of responsibility might make use of a PVRR analysis. (Tr. at 130.) Mr. Starbody also noted that he was responsible for making the decisions con-

cerning the retirement of the Freeburg propane facility and the Gillespie storage facility. (Tr. at 76-77; 86-87.) Further, he noted his response regarding his view of the value of conducting PVRR analyses was based on his involvement in retiring the Freeburg and Gillespie facilities. (Tr. at 131.) Mr. Starbody's failure to consider a PVRR analysis when making a decision about these types of facilities is a major change from past IP activity before the Commission, and is imprudent

4. IP had Non-Economic Basis for Retirement

IP provided a list of reasons it claims were sufficient to justify the retirement of the facility without performing an economic analysis. These concerns included safety concerns associated with the need to transport, handle and maintain an 800,000 gallon liquid propane storage inventory, the growth of the surrounding area, the need for substantial capital expenditures on the facility and for additional expenditures in the future as the plant continued to age, and the likelihood of more stringent regulations becoming applicable to the facility. (IP BOE at 3.) However, the point that cannot, and should not, be overlooked is that every reason provided by IP in an attempt to justify the Freeburg facility retirement was supplied to Staff after the decision was already made, and no evidence was presented that suggests these reasons were contemplated before the decision for retirement was made.

It is noteworthy that this list was IP's final position in the matter. IP's initial "basis" for retiring the facility, according to IP's response to Staff data request ENG 2.99, was that the propane facility had reached the end of its useful life and was therefore retired. IP reported that its facility was installed in 1971 and had obsolete refrigeration compressor controls and switchgear. IP further stated that the fire protection and gas detec-

tion equipment did not conform to current standards and, finally, the refrigerated sphere insulation was failing and needed to be replaced. (Revised Staff Exhibit 2 at 5-6.) It was only after Staff questioned IP's lack of support for its decision that IP came up with its final and much more expanded list. Further, it is interesting to note that one of IP's claimed reasons for retiring the facility was that its equipment did not meet current standards. However, the third party expert witness IP hired to provide surrebuttal testimony after conducting a safety analysis of the Freeburg Propane Plant indicated the plant was compliant with all existing safety regulations. (IP Exhibit 4.3 at 4; Tr. at 163.)

5. Statements Regarding Retirement of Other Facilities

IP notes that it has retired four other propane plants in the preceding six years and that it did not perform PVRR analyses and had no demands for PVRR analyses when it made those decisions. (IP BOE at 8.) The record in this proceeding does not support or dispute that assertion, since there is no record discussion of the retirement of IP's other propane plants. IP is attempting to influence the outcome of this proceeding through the use of unfounded statements. The retirements of these facilities were never discussed in the Company's testimony and are not facts in evidence in the current matter.

B. Proposed Order's PVRR Assumption

IP asserts that the PVRR reflected in the PO does not support the decision that the Freeburg facility retirement was imprudent. IP claims the replacement gas costs were overstated and the necessary repair costs were understated. (IP BOE at 9.) According to IP, if both of those assumptions are changed, it can show that it was cor-

rect to retire the Freeburg facility, even though it did not conduct a PVRR or any other economic analysis at the time it made the decision.

1. Replacement Gas Costs

IP states the PVRR calculations contained in the PO should use IP's projected price for winter-only firm transportation ("FT") as the appropriate value for replacement gas costs. (Id.) IP projected a contract for winter-only FT that would have replaced the capacity from the Freeburg Propane Plant would only cost $588,126. (IP Exhibit 3.6 at 6.)

IP's recommendation to use $588,126, rather than Staff's known quantity of $1,273,000, is based upon the assumption that IP would only procure winter transportation capacity as opposed to year round capacity. (Id. at 5.)

IP's calculation was not based upon any contracts that it has signed; instead, IP simply took the annual gas cost for its existing year round FT contracts, determined the discount that IP received for that service versus current maximum rates, and then assigned that discount to the current maximum winter rates. (Revised IP Exhibit 3.6 at 5-6.)

However, IP admits that winter-only service comes at a premium. (Id. at 5.) Therefore, it is not intuitive that a discount IP received for a year-round contract is applicable to the more desirable winter-only service. Winter-only service is more valuable because the natural gas peak demand occurs during the winter, primarily to heat homes. During the non-winter months, pipelines do not operate near full capacity. In fact, it is likely that IP may not be able to receive any discount from maximum rates for winter-only service. Hence, IP's calculation is mere speculation.

IP also claims that economical winter FT was known by 2001. Staff disputes this statement. As noted above, IP's only support was a projection of a possible rate. Staff's number, which came from IP, was included in its direct testimony. If this alternative gas cost was a known quantity, then IP had the opportunity to provide in its rebuttal or surrebuttal testimony the exact rate it received when it signed those types of contracts. However, that did not happen. Instead, IP provided an "estimate" in its surrebuttal testimony. (Revised IP Exhibit 3.6 at 5-6.) This demonstrates that IP is attempting to avoid an adjustment for its determination to retire the Freeburg facility. The Commission should not be deceived by this attempt. The Proposed Order made the correct decision to use the gas costs that IP had incurred at the time the decision to retire the facility was made in the PVRR calculation.

Not only does the Company want the Commission to consider the "estimated" winter FT rate as a fact, but IP also requests the Commission violate its own prudence standard and reconsider the PVRR results using this "estimate" value as a known value for future replacement gas costs. In essence, IP is ignoring the prudence standard of only using information that should have been known at the time the decision was made and instead inserting its "estimated" replacement gas cost amount. Once that baseless assumption is made, then a PVRR analysis conducted now may show IP was correct in retiring the facility. The prudence standard does not allow that type of after-the-fact analysis; rather, in determining whether a decision is prudent only those facts available at the time the decision was made are considered.

[1]Staff conducted the PVRR within its rebuttal testimony because IP failed to provide any economic studies in the record to support its decision to retire the Freeburg Propane Facility and the Gillespie Storage Field, aside from amending Staff's study within its surrebuttal testimony.

2. Higher Capital Costs

IP also notes that the PVRR analysis reflected in the PO does not include all of the capital cost estimates that IP provided for potential renovations and upgrades. (IP BOE at 9, footnote 4; IP BOE at 12, footnote 8.) Staff disagrees. The record's discussion of IP's various costs estimates indicates that the proper value is being used within the Proposed Order.

a. Costs to Upgrade the Freeburg Propane Facility

In its rebuttal testimony, the Company noted it estimated that it would take $1,873,000 to renovate the Freeburg Propane Facility. (Revised IP Exhibit 3.2 at 4.) However, once Staff used IP's figure for its analyses, IP generated additional testimony that suggested $2,500,000 was more appropriate. (IP Exhibit 3.6 at 8.) Staff disputed most of that revised amount. IP's basis for the increased capital costs was the testimony of Dr. Russell Ogle. Dr. Ogle was hired on July 26, 2001, to examine the Freeburg facility and to "perform an independent safety analysis of the Freeburg facility." (Revised IP Exhibit 4.3 at 1.)

Ogle developed a list of capital items that increase the cost to renovate or operate the facility on an on-going basis. (Id. at 4.) As the PO noted, Staff agreed with two of those items, namely the cost to update engineering documents and to conduct an inspection of the sphere. However, Staff disagreed with the cost to develop a new operator training program at a cost of $50,000 and for additional fire protection equipment at a cost of $500,000. (Id.) IP has failed to demonstrate that these costs are necessary.

IP suggests that it needs to spend $50,000 to update its operator training program. However, this amount exceeds the total amount of operations and maintenance expense at the facility for the period 1998 through 2000 ($9,900 + $10,500 + $15,900 = $36,300) and almost exceeds the combination of operation and maintenance ("O & M") and capital expenditures for this same time period ($36,300 + $24,400 + $1,600 = $62,300). (Staff Cross Exhibit 7.) Curiously, despite his report to the contrary, on cross-examination, Dr. Ogle did not note any shortcomings in IP's existing training program for its employees that operate the Freeburg facility. (Tr. at 163.) Given the magnitude of this "update" versus historical expenditures at the plant and the lack of any problems with the existing training program, it is clear that $50,000 to update IP's operator training program is unnecessary.

Finally, it is clear that at the time the Freeburg facility was retired, no additional fire protection equipment was needed. Ogle's assumption that an additional $500,000 in fire protection equipment is necessary is pure conjecture. Dr. Ogle noted that depending upon the level of fire risk deemed acceptable by IP, it might be necessary to install the $500,000 fire monitors. (emphasis added) (Id. at 3.) However, there is no regulatory requirement for IP to do so. (Tr. at 162-163.) IP has operated this facility for 30 years without the need for this equipment and there is no requirement for it. IP's attempt to factor this cost within the PVRR analyses is simply another hindsight attempt to overstate the amount of capital necessary to renovate the facility in order to justify its original decision regarding the retirement of the facility.

b. Additional Future Capital Expenditure

In its revision to Staff's PVRR analyses, IP assumes that an additional capital expenditure of $200,000 is necessary every three years throughout the remaining assumed life of the facility. (IP Exhibit 3.6 at 6.) IP's basis for this assumption is its claim that additional capital projects would be necessary in the future to keep the facility operating. Staff does not agree with this value. Staff does agree that some level of future capital expenditure could be considered; however, IP's estimate is much too high, and as noted *supra*, IP conducted no studies or analyses regarding what expenditures would be needed.

The assumption of $200,000 is contrary to IP's historical operation of the facility. The capital expenditures at the Freeburg Propane Facility for the years 1998 through 2000 ranged from zero to $24,400. (Staff Cross Exhibit 7.) In 1995, IP installed one piece of equipment and in 1996, replaced one piece of equipment at the facility. (Staff Cross Exhibit 10.) The details for 1998 show the replacement of various items. (Id.) However, IP's response to a Staff data request indicates that in 1998 there was expense associated with no capital additions. (Staff Cross Exhibit 7.) In fact, the largest amount of capital additions that IP experienced at Freeburg occurred in 1999 with a total of $24,400. IP's responses to Staff data requests conclusively establish that $200,000 is a highly inflated figure.

The information provided by IP does not support its contention that an additional $200,000 in capital expenditures is required every three years. Further, making major upgrades to the facility should decrease, not increase, the need to repair and replace items at the facility in the future. While Staff agrees that some small amount could be

assumed for future capital expenditures, the evidence does not support IP's figure of $200,000.

It also bears mentioning that Staff intentionally overstated IP's O&M amounts within the PVRR analyses, which, in part, provides some leeway for future capital expenditures. Staff assumed $35,000 as the annual O&M amount for Freeburg, which was based on the Company's response to Staff data request ENG 2.186. (Revised Staff Exhibit 4.0 at 6; Staff Cross Exhibit 7.) According to IP, for the period 1998 through 2000, it experienced O&M levels of $9,900, $10,500, and $15,900, respectively. (Staff Cross Exhibit 7.) However, the combined costs of O&M and capital from that exhibit for the same time period provide values of $9,900, $34,900 and $17,500, respectively. Unlike many of the Company's assumptions, Staff made conservative estimates in its values within the PVRR analyses.

C. Proposed Order Fails to Give Sufficient Weight to Safety and Other Concerns

IP agrees with the Proposed Order that safety and reliability are legitimate concerns as the plant continues to age, but argues that the PO failed to give those various concerns the proper weight. In fact, IP wants the Commission to believe that if the PO had afforded IP's concerns the proper weight, then a PVRR analysis would not need be performed. As demonstrated below, IP's overstated concerns are unfounded.

1. Residential Development

IP claims that it was concerned about the continued operation of the Freeburg Propane Facility because the area surrounding the site of the plant had been experiencing residential growth. (IP BOE at 16.) IP also contends that thickly settled residential areas have been moving closer to the plant site. (Id.) Because of this

encroachment, IP alleges that safety issues associated with the residential areas developing near the plant were a significant factor in the decision to retire the plant. (Id.) However, upon review of these claims, IP's position is meritless.

The Company put forth its initial concerns regarding the residential development in its rebuttal testimony. As a result, Staff toured the Freeburg facility on July 19, 2001 and reviewed the area surrounding the facility in an attempt to verify IP's comments. (Revised Staff Exhibit 4.0 at 6.) This review indicated that the residential growth reported by IP was a significant distance away. (Id. at 7.) In fact, the closest new residential development was approximately 4.3 miles away from the facility. (Id.) This residential development is taking place south of the community of Smithton along Illinois Highway 159. (Id.) All other residential growth areas were also occurring south of Smithton along Highway 159. (Id. at 6-7.)

The Freeburg facility is not located along Highway 159. (Id. at 7.) The facility is located about 2.5 miles south of the community of Freeburg along Illinois Highway 13. (Id.) No new residential development in the immediate vicinity of the existing Freeburg Propane Facility was observed. (Id.) IP claims that its safety concerns were based on the trends in the development of the surrounding area over a period of years. (IP BOE at 16.) IP further asserts that its concerns were based upon the likelihood that development would continue to move closer to the site over the time period needed to operate the Freeburg facility in order to justify the capital expenditure necessary to renovate the facility. (Id.) However, the facts simply do not support IP's position. Aside from a few scattered homes, there is no newly developed dense residential development closer than four miles to the facility. (Revised Staff Exhibit 4.0 at 7.) The residential develop-

ment that has occurred in the area is on a different highway than the highway where the Freeburg facility is located. (Id.) Also, as has been the pattern in this case, IP failed to mention potential residential encroachment as a basis for retiring the Freeburg facility until its rebuttal testimony.

In direct conflict with its assertion that potential development around the facility was a significant factor to close the plant, is that any future development would also have to contend with the various injection/withdrawal wells and associated piping in place at the Freeburg natural gas storage field. (Id.) The Freeburg Propane Facility is not a stand-alone facility. The major equipment associated with IP's Freeburg natural gas storage field is located at the same site as the propane facility. (Id.) This coexistence occurred when the propane facility was initially placed in service in 1971. (Id.)

2. Freeburg Facility Safety

IP noted that it had safety concerns with encroaching residential areas because this made the risks and consequences associated with gas leakage or fires that are inherent to propane facilities a matter of increasing concern. (BOE at 18-19.)

In response to this alleged concern, Staff requested that IP provide it with the history of the leaks and/or fires that had occurred at the Freeburg Propane Facility. In response to this request, IP was only able to provide two known occurrences. The first event was a fire that occurred in June of 1985. (Revised Staff Exhibit 4.0 at 8.) The fire was the result of lightning igniting propane vapors seeping from three of four relief valves on top of the refrigerated sphere. (Id.) IP replaced those relief valves and installed a lightning protection system at the tank perimeter to alleviate the possibility of a reoccurrence. (Id.)

The second event occurred in October 1995 when a minor leak occurred on an orifice fitting that was used to measure propane being transferred between the surge drum and the refrigerated tank. (Id. at 8-9.) IP isolated the orifice fitting, removed it from the piping, and shipped it to the manufacturer for repair. (Id.) The manufacturer repaired the casting defect and the repaired unit was reinstalled upon its return. (Id.)

The history of the facility itself dispels IP's argument that the plant is susceptible to leaks and fires. In fact, the evidence suggests that the facility has been extremely safe during its operation. On the one occasion that a fire did occur, IP took action to prevent reoccurrence of a similar event. Nothing in the plant's history provides any support to the Company's contention that there is reason to be concerned about the plant's safety.

3. Packer Engineering Report

IP claims the Packer Engineering ("Packer") Report demonstrates the risk (however remote) of a propane explosion that could result in the potential for damage to persons or property in the area surrounding the Freeburg Propane Facility. (IP BOE at 17.) This report resulted from IP, prior to filing its surrebuttal testimony, retaining the services of Packer to perform what it calls an "independent safety analysis" of the Freeburg facility. (Revised IP Exhibit 4.3 at 1.) A portion of that analysis was to estimate what would happen if the Freeburg facility experienced a Boiling Liquid Expanding Vapor Explosion ("BLEVE"). (Id. at 2.)

The report presented a list of five accidents where a BLEVE had occurred. (Id. at 2-3.) Of these accidents, relied upon by Packer to opine about the danger of propane explosions, one BLEVE event occurred in 1966, three occurred during the 1970s, while

the most recent event occurred in 1984. (Id.) Only two of those five events occurred within the United States and one of those occurred after a train derailed while transporting propane rail cars. (Id.) One accident at a propane facility in the United States within the last thirty-five years suggests an impeccable safety record for this type of plant.

However, the issue is not whether a propane explosion can occur; rather, the issue is whether or not safety was a legitimate concern when the Freeburg facility was retired. The evidence overwhelmingly suggests otherwise. Packer was not retained by IP until July 26, 2001. (IP Exhibit 4.1 at 1.) Thus, eighteen months after IP made its decision to retire the facility it retained an expert witness to help justify that decision. IP never had access to the Packer Report when making its initial decision regarding the retirement of the propane facility. Second, upgrading and renovating the propane facility, if anything, should improve the plant's safety, not reduce it. The purpose of the Packer Report is obvious: to provide hindsight justification for closure of the Freeburg facility eighteen months after that decision was already made.

The possibility of a BLEVE did not stop IP from installing the propane facility at the same location as its Freeburg storage field in 1971. In fact, IP's witness agreed the BLEVE results would have been the same in 1971 as when he calculated it for his analysis. (Tr. at 159.) Finally, the history of BLEVE events is extremely limited, with only two occurring in the United States over the last 35 years and as noted above one of those incidents only occurred after the derailment of propane rail cars. The storage of propane and other petrochemicals occurs every day within the United States. The

possibility that a BLEVE can occur does not provide adequate justification for retiring an existing facility that operated virtually without incident for 30 years.

4. Refueling the Freeburg Propane Facility

IP also addresses concerns with the number of tank truck deliveries that are necessary to replenish the facility. (IP BOE at 17.) However, 90 trucks are needed only if the propane facility needs to be completely refilled. (Id.) IP admits that the facility was only called upon a total of six times during the five-year period 1995 through 1999. (Id. at 14.) This equates to operating, on average, slightly more than one time a year. Assuming the facility operated at full capacity on each of those occasions, which it likely did not, the amount of propane necessary for refill is one-third the total capacity (or 30 trucks) during the year.

Even if one assumes the facility is completely depleted of its propane supply and requires 90 truck deliveries, the facility only operates in the winter. IP has at least seven non-winter months to refill the facility. Seven months equates to at least 28 weeks or an average of about three trucks per week to refill the facility. Further, IP notes that there is also the possibility of conducting the propane refills via rail cars rather than trucks since a rail line runs near the facility. (IP Initial Brief at 3, footnote 2.) At worst, the area could experience an average of three truck deliveries to the facility per week for seven months out of the year. This hardly constitutes a basis for retiring the facility.

5. Operator Training

IP noted the Packer Engineering Report identified the potential need to develop a new operator training program. (IP BOE at 15, footnote 10.) As such, IP further noted that the need for this specialized training and expertise, combined with the infrequency with which the plant actually needed to be operated and the resulting lack of hands-on operating experience, were additional factors leading to the closing of the Freeburg facility. (Id.) IP further noted that it was concerned that if additional regulatory requirements were applied to the renovated propane facility, then there could be an increase in operator training and qualification requirements. (emphasis added) (Id., footnote 9.)

Staff's review of this issue found that IP's existing training program for the Freeburg facility was hands-on and was performed during the annual testing of the plant during which the vaporizer heating system was started and operated one day. (Revised Staff Exhibit 4.0 at 9.) If appropriate conditions existed, then on the second day the propane injection system was also tested. (Id.) This training program was sufficient in the past to satisfy IP's needs. Also, since the Freeburg storage field and propane facility were located at the same site, IP cross-trained those employees to operate both facilities. (IP Exhibit 3.6 at 15.) It is inexplicable how the need to maintain an existing training program, or even the possibility of expanding the existing training, is a valid reason for retiring the Freeburg facility. Further, IP was not sure if new codes and standards would apply to the facility. This is an additional indication that IP did not genuinely investigate the possibility of retaining the Freeburg facility.

6. Plant Reliability

IP noted a concern regarding the continued reliability of the Freeburg facility. (IP BOE at 18-19.) Staff's review found no reason to agree with the Company's concern over the plant's reliability.

IP's concern regarding reliability is based on only four incidents that occurred at the Freeburg facility. Two of those incidents involved pipeline corrosion leaks; one was a pump seal leak, and the final item was failure of a back pressure controller. (Revised Staff Exhibit 4.0 at 10.) Given the 30-year history of the facility, only four incidents contradict concerns about the plant's reliability. Also, upgrading and renovating the facility should, at worst, maintain the reliability level of previous years and could increase the plant's reliability in the future. Therefore, the Company's concern about the Freeburg facility's reliability is invalid.

7. Preference for FT Contract

In an attempt to provide support for an intangible benefit associated with the retirement of the Freeburg Propane Facility, IP notes a replacement pipeline FT contract of equivalent capacity would provide the ability to bring gas into IP's system during the entire winter rather than just a few days out of the year. (IP BOE at 14-15.) In support of this "benefit", IP notes that the Freeburg facility was only able to provide three days of service at full capacity during the winter season. (Id at 14.) Further, IP noted that from 1995 through 1999, the facility was only called upon six times. (Id.) However, Staff does not see those facts as support for IP's argument. The Freeburg facility, and all propane facilities for that matter, normally only operate when temperatures create the potential for peak demand. Replacing the Freeburg facility with a FT contract causes IP

to pay for a service it only needs, on average, once a year. That situation provides no benefit to IP's ratepayers.

II. GAS PURCHASING ACTIVITY

IP disagrees with the Proposed Order's conclusion regarding its insufficient criteria for selecting its winter swing contracts. IP has three primary reasons for disagreement. First, IP claims it has previously used the same method for selecting swing contracts. (IP BOE at 21-22.) Second, IP does not believe a usage rate can be easily calculated. (Id. at 23-24.) Finally, IP believes the Proposed Order ignored the savings it claims results from use of the criteria in question. (Id. at 25-26.)

A. Historical Relevance

IP claims that Staff's recommended adjustment is in conflict with Staff's prior position on this subject. (Id. at 22.) IP's support for this claim is a statement from its witness in Docket No. 99-0477, IP's 1999 reconciliation proceeding, who stated that during 1999, IP used the lowest reservation cost methodology as the basis for selecting its firm winter supply contracts. (Id. at 21.) IP further notes that Staff found no reason to question the prudence of this activity. (Id.) Staff agrees that the Order from IP's 1999 reconciliation proceeding makes these statements; however, Staff does not agree with IP's conclusion regarding those statements.

IP's argument fails to provide any information that indicates the purchasing decisions faced by IP in 1999 bear any similarity to the decisions that IP faced in 2000. Specifically, did any of the contracts signed by IP in 1999 have alternative bids that offered a lower commodity cost but a higher reservation cost that IP could have accounted for prior to signing the contracts? IP has the burden to show that its gas

contracts were prudently entered into, and it has failed to do so. If there was no commodity difference between competing bids, then selecting the gas supply contracts on the basis of lowest reservation costs was the appropriate strategy to employ. However, IP fails to supply any information that its 1999 purchasing activity encountered the same set of circumstances as those during the 2000 reconciliation period. Without specific information regarding the alternative bids that was available to IP in 1999, any attempt to reach a conclusion from statements made in 1999 is pure supposition. Further, IP was remiss in its failure to discuss this alleged conflict during the course of the instant proceeding. If IP had made the same type of decisions with similar circumstances in 1999 as in 2000, then Staff would have expected IP to bring this conflict to light in its testimony or the cross of Staff's witnesses. However, IP never raised the issue until its Initial Brief. IP's failure to advance this argument at an earlier date suggests the 1999 reconciliation was not comparable to the review conducted in the instant proceeding.

Further, Staff is aware of at least one difference between the 1998, 1999 and 2000 reconciliations. Staff requested IP to provide it with a listing of the top five suppliers for the years 1998 through 2000. In 1998 and 1999, the listing of suppliers remained constant. (Tr. at 99-100.) However, in 2000, the year at question in the instant proceeding, there was a change. For the first time, Dynegy Marketing and Trade ("Dynegy"), (of which, coincidentally, IP is an affiliate) made the top five list. Also, one of the swing contracts in question in this proceeding was made with Dynegy. IP's supplier listing and none of the past IP PGA proceedings indicate a large amount of activity between IP and the subsidiary of its parent company. The extent that any conflict exists

within this relationship and the fact that one of the contracts in question in this proceeding was with Dynegy were not issues in any pre-2000 PGA reconciliations.

B. Usage Rate Calculation

IP takes issue with the Proposed Order's conclusion that its selection criteria wrongly assumes that no gas will be taken under the swing contracts. (IP BOE at 23.) Instead, IP believes the issue is how to predict how much gas will be taken under those contracts. (Id.) Staff disagrees with the Company's arguments. The Proposed Order correctly identified that IP ignored commodity costs differences when it assigned its firm winter swing contracts.

IP agrees that it could engage in the exercise of taking commodity costs into account. (Id.) However, IP believes the numerous factors that it could account for within an analysis to determine usage rates and their accuracy would completely overwhelm the certainty of any projections. (Id.) As support for its statements, IP provided a listing of the various load factors it has experienced with its swing contracts over the past two winter seasons and concludes there is no predictability with the value. (Id. at 24.)

Essentially, IP's argument boils down to, since any value it would calculate could be wrong and there is variability within historical usage rates for swing contracts, IP should just ignore any commodity differences. Staff disagrees. IP should consider all factors when assigning gas supply contracts in order to provide the lowest cost gas service for its customers. Further, IP attempts to overly complicate the analysis for the amount of gas purchased under these contracts. For example, one of the contracts in question involved a supply contract with Dynegy. Staff calculated a break-even load

factor amount based upon the commodity and reservation difference that existed between the Dynegy contract and the next best alternative as 25%. (Revised Staff Exhibit 4.0 at 23.) Thus, if IP used less than 25% of the volumes available from that contract, the contract with the lower reservation fee provided the lowest total gas supply costs. (Id.) However, if IP used more than 25% of the volumes from that contract, the contract with the lower commodity costs provided the lower total gas supply costs. (Id.)

A historical review of IP's usage rates for its swing contracts indicates that IP should account for commodity cost differences. During the winter of 1999-2000, IP entered into 16 firm swing contracts whose average load factor was 26.8%. (Id. at 24.) This is higher than the break-even load factor calculated for the Dynegy contract. This value was available to IP prior to its decision to enter into the Dynegy and its other swing contract at issue in this proceeding. However, IP failed to consider this information when making its decision to enter into those contracts.

IP's failure to account for commodity differences between competing offers when assigning winning gas supply contracts is not a prudent practice. A simple comparison between IP's past usage rates for its swing contracts and the break-even analysis of alternative supply bids should have caused IP to consider more than just reservation costs when assigning its firm winter swing contracts. IP's failure to follow prudent purchasing practices caused it to incur an additional $3,000 in gas supply costs during the reconciliation period. IP, not its customers, is responsible for those decisions. Therefore, IP should be held responsible for those costs.

C. Savings Calculation

IP also claims that its swing contract selection criteria resulted in a total overall savings to its customers. (Id. at 25.) In fact, IP claims that the five swing contracts. it signed had lower commodity costs than the next best offer, thus it realized a total aggregate savings of $16,815 during 2000. (Id.)

However, it is Staff's position that two of those five contracts should not be included in that comparison. Two of the five contracts in question have a commodity rate difference that equals the reservation rate difference. (Revised IP Exhibit 3.5, Contracts 2 and 4.) The same rate difference means that it is impossible for the contract with a lower commodity cost to have lower total gas supply cost than the contract with the lowest reservation fee. The reason this occurs is that the break-even point for both of those contracts is at a 100% load factor usage rate. Therefore, for those two contracts it is obvious that they were the prudent selection for IP to make and should not have been included in IP's analysis.

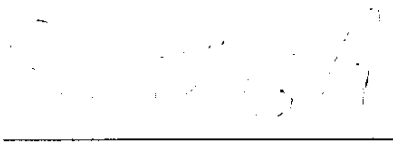
Excluding the comparison made for Contracts 2 and 4 in Revised IP Exhibit 3.5 (the two contracts that had a 100% load factor for the break-even point) drastically changes the results of IP's analysis. In fact, IP's analysis now shows a total gas cost increase to ratepayers, rather than a savings. For the remaining three contracts that had an alternative bid with a lower commodity rate, IP's selection of two of them caused it to incur higher total gas costs. In other words, IP was correct only one-third of the time when selecting the best swing contract for its ratepayers when there was a valid commodity price difference to consider.

IP also noted that one of the contract comparisons calculated by Staff was for only half of the capacity of the contract it replaced. (IP BOE at 25, footnote 15.) However, as Staff discussed in its rebuttal testimony, since it was not known whether or not IP could have obtained more than the bid amount shown, Staff made the conservative assumption that IP would be limited to 10,000 MMBtu. (Revised Staff Exhibit 4.0 at 25.) Staff made this assumption even though IP had during two occasions in 2000 contracted for significantly more than the initial bid limits. (Id.) Therefore, Staff made its calculation using just the original bid limits provided for that particular contract.

III. CONCLUSION

For the foregoing reasons, Staff respectfully requests that the Commission approve the October 17, 2001, Proposed Order with the modifications proposed by Staff in its October 31, 2001, Brief on Exceptions.

Respectfully submitted,



STEVEN L. MATRISCH
LINDA M. BUELL
Staff Attorneys

Counsel for the Staff of the
Illinois Commerce Commission